

An Introduction to Alaska Fiscal Facts and Choices

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UNIVERSITY of ALASKA ANCHORAGE

Alaska faces a significant fiscal challenge.

My goal in this presentation is to help Alaskans understand the most important facts about our fiscal challenge and the choices we face.

Part I is about Alaska fiscal facts:
State revenues, spending and savings

Part II is about Alaska fiscal choices:
The choices we face about how much to spend and how to pay for it.

I. ALASKA FISCAL FACTS

State revenues
State spending
State savings

The state receives many kinds of revenues which we spend in many ways.

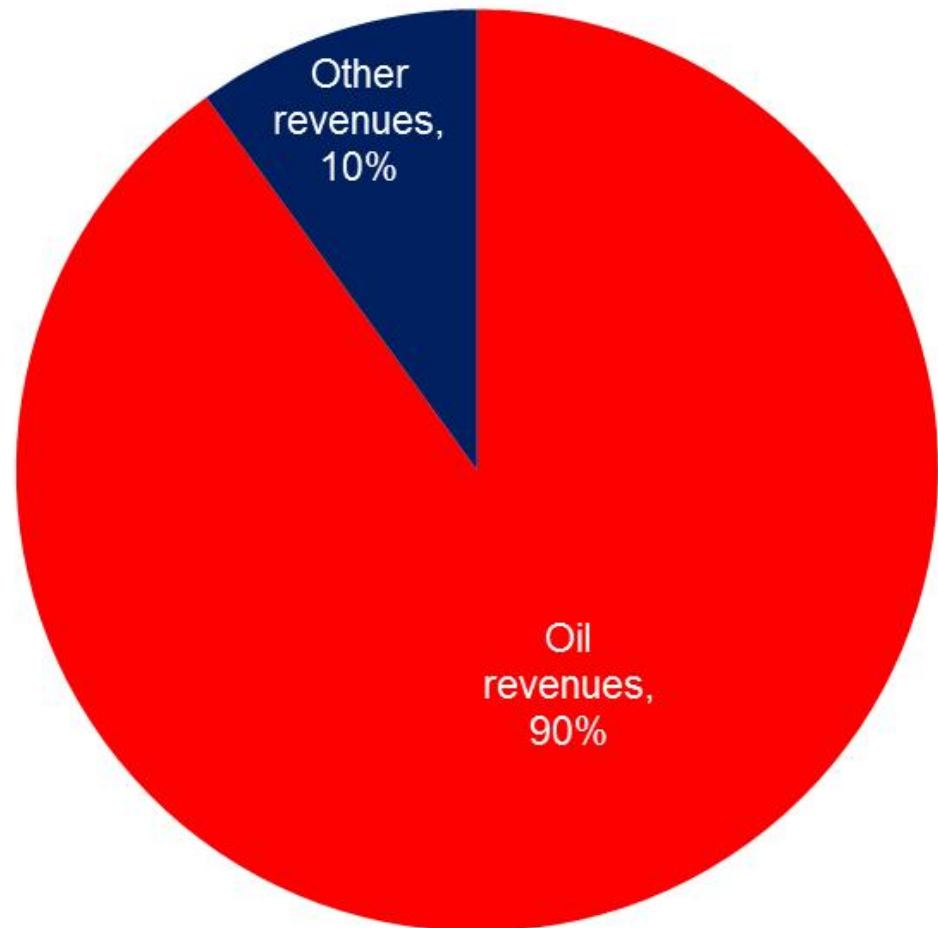
Our fiscal debate is mostly about **unrestricted general fund revenues** which pay for most of state government.

We also receive and spend a lot of other revenues, but we are restricted—to varying degrees—in how we choose or are allowed to spend them.

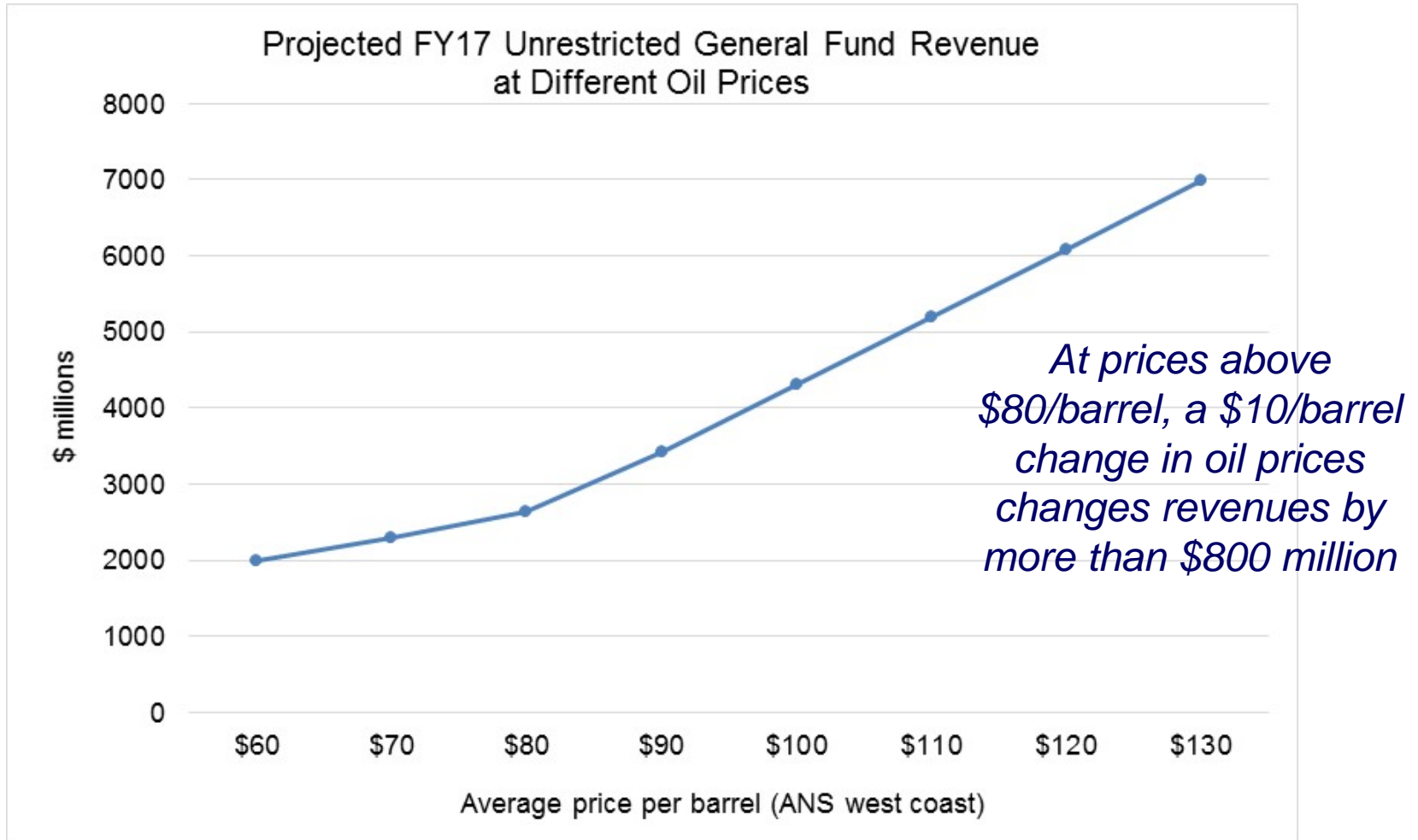
| Type of revenues | How we can use them | Estimated FY15 revenues |
|--|-----------------------------|-------------------------|
| Unrestricted general fund revenue | Any way we wish | \$2.2 billion |
| Restricted revenues | Restricted by custom or law | \$7.4 billion |
| <i>Federal receipts</i> | | <i>\$3.1 billion</i> |
| <i>Permanent Fund investment revenue</i> | | <i>\$3.0 billion</i> |
| <i>Charges for services</i> | | <i>\$0.3 billion</i> |
| <i>Other</i> | | <i>\$1.0 billion</i> |
| Total revenues | | \$9.6 billion |

Alaska has been extremely dependent on oil revenues to fund state government.

From 2005 to 2014, oil revenues averaged 90% of Alaska's unrestricted general fund revenues



Our state revenues are extremely sensitive to oil prices
—particularly at prices above \$80/barrel.



This year oil prices fell drastically and unexpectedly

Daily ANS West Coast Oil Price



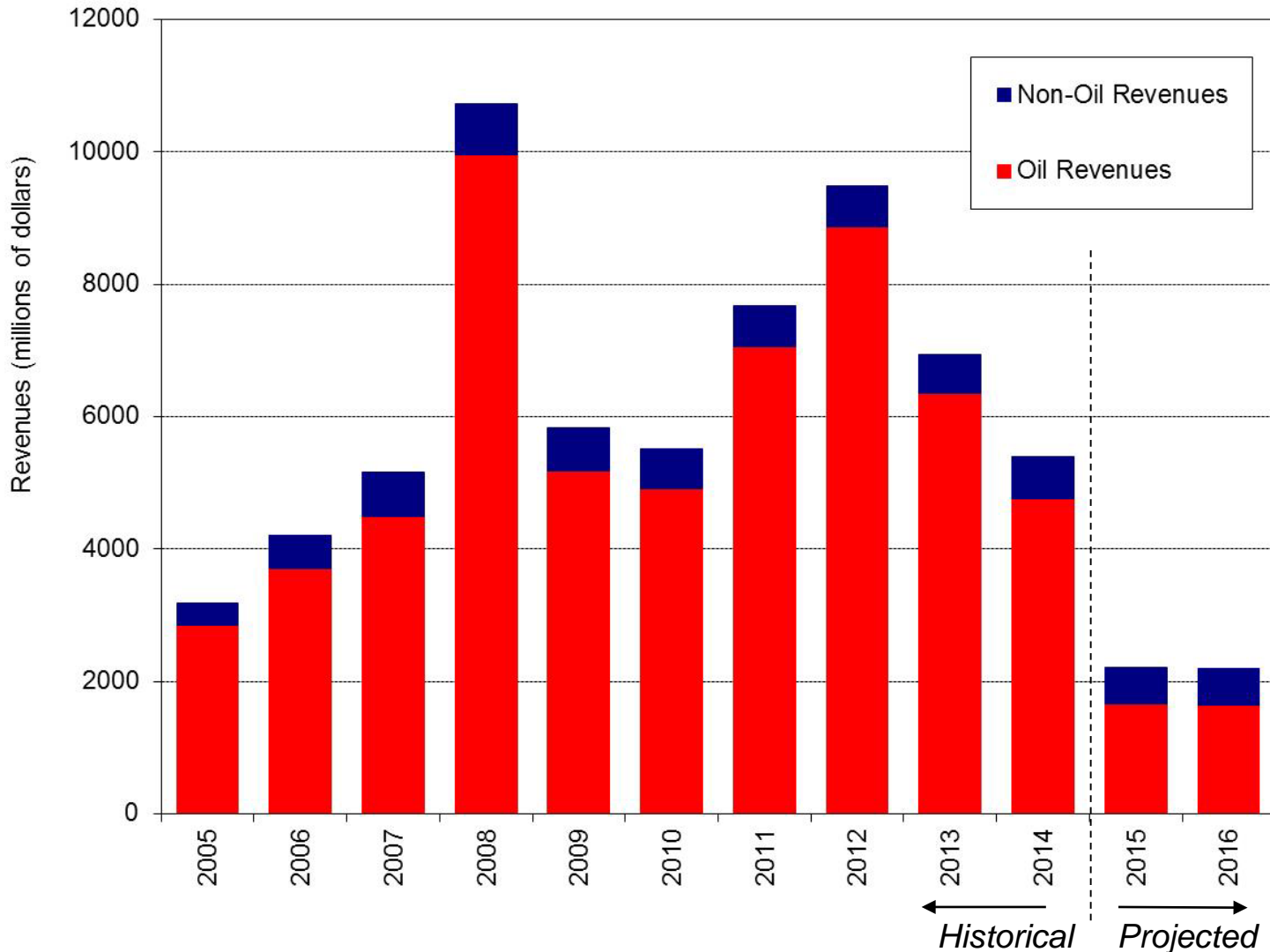
Last spring the Department of Revenue (DOR) projected an average FY15 price of \$105/barrel

This spring DOR projected an average FY15 price of \$67/barrel

The June 3 price was \$64/barrel (below the average projected price)

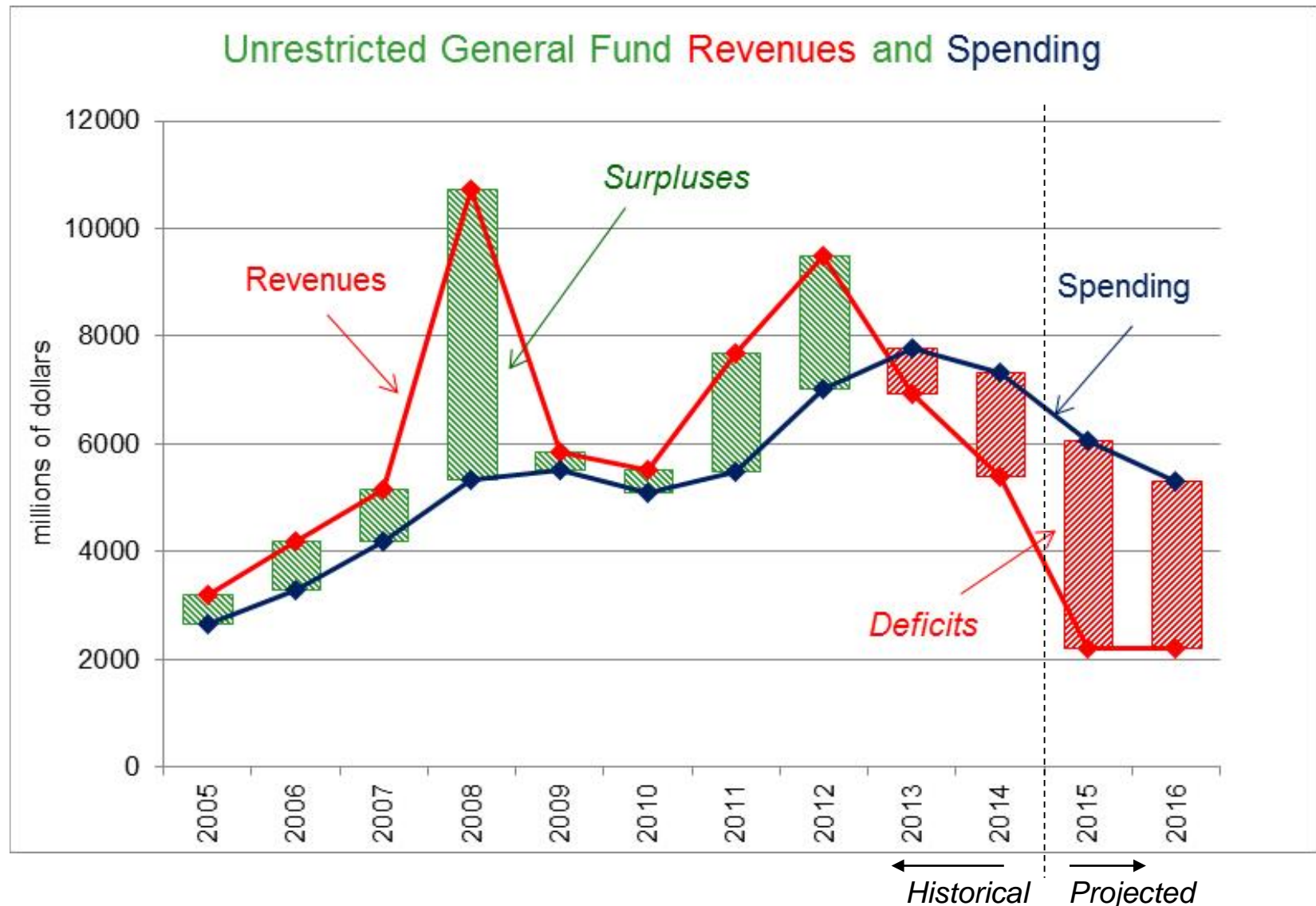
Mostly because of the fall in oil prices, our oil revenues have fallen drastically.
Falling oil production and higher costs and credits have also played a role.

Alaska Unrestricted General Fund Revenues

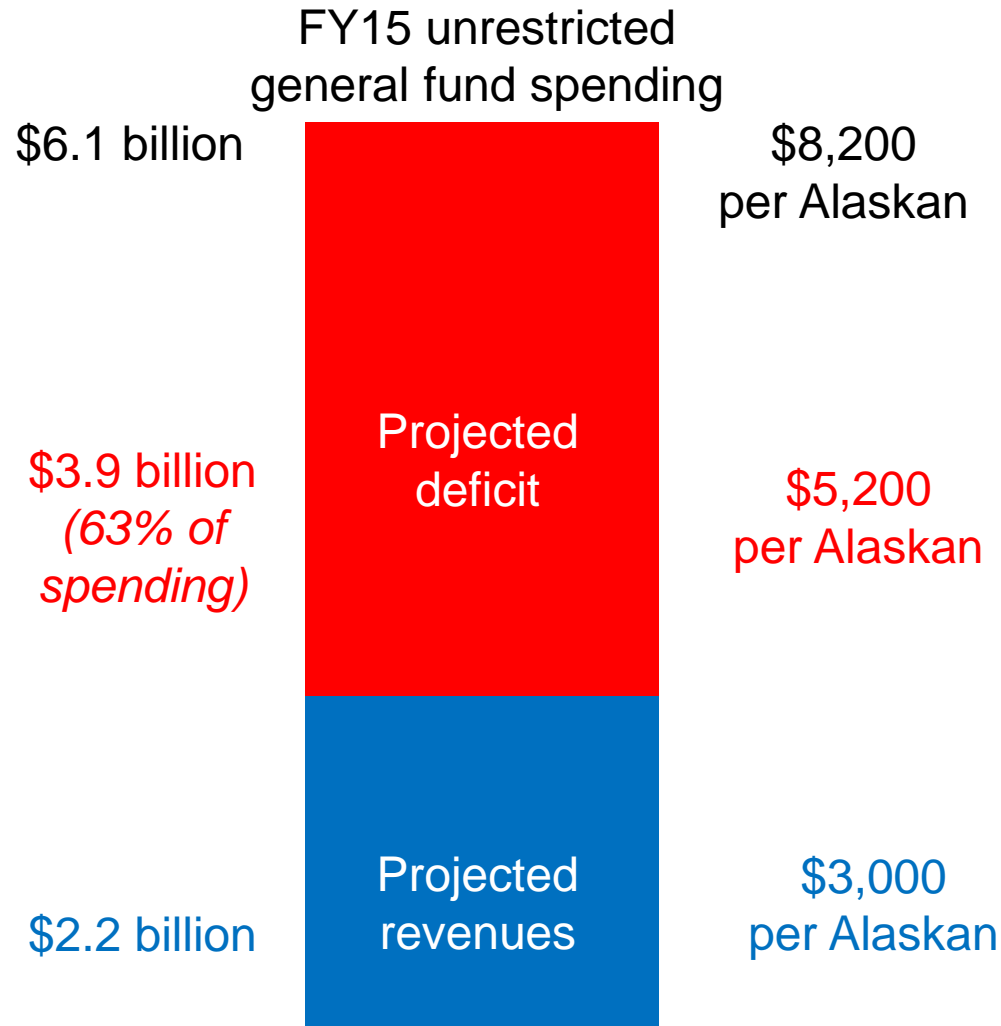


*\$7.2 billion
drop in oil
revenues
from 2012
to 2015
(81% drop)*

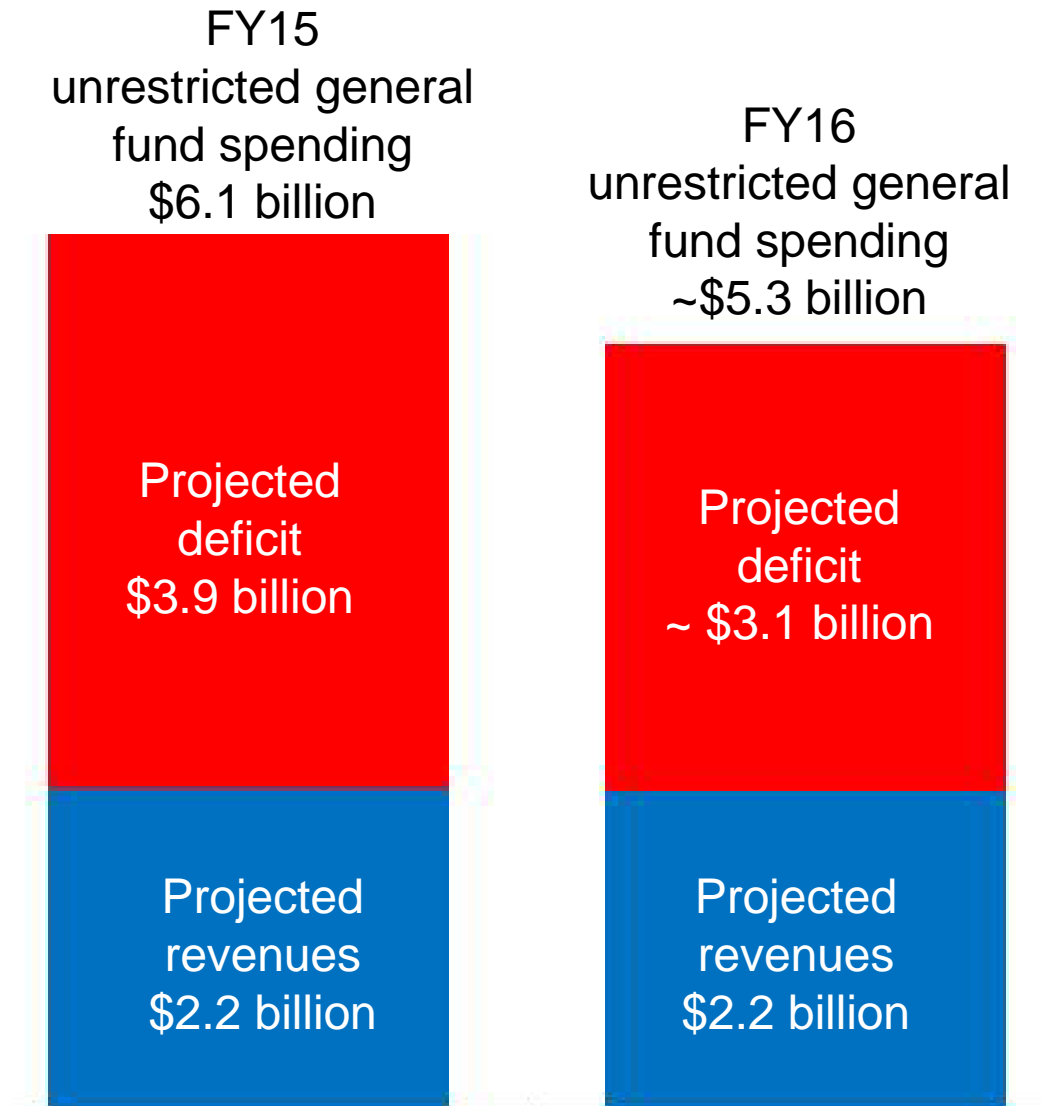
From 2005 to 2012, even though spending was rising, we ran big General Fund surpluses. Since 2013 we have been running big General Fund deficits.



This year's (FY15) projected deficit is huge.

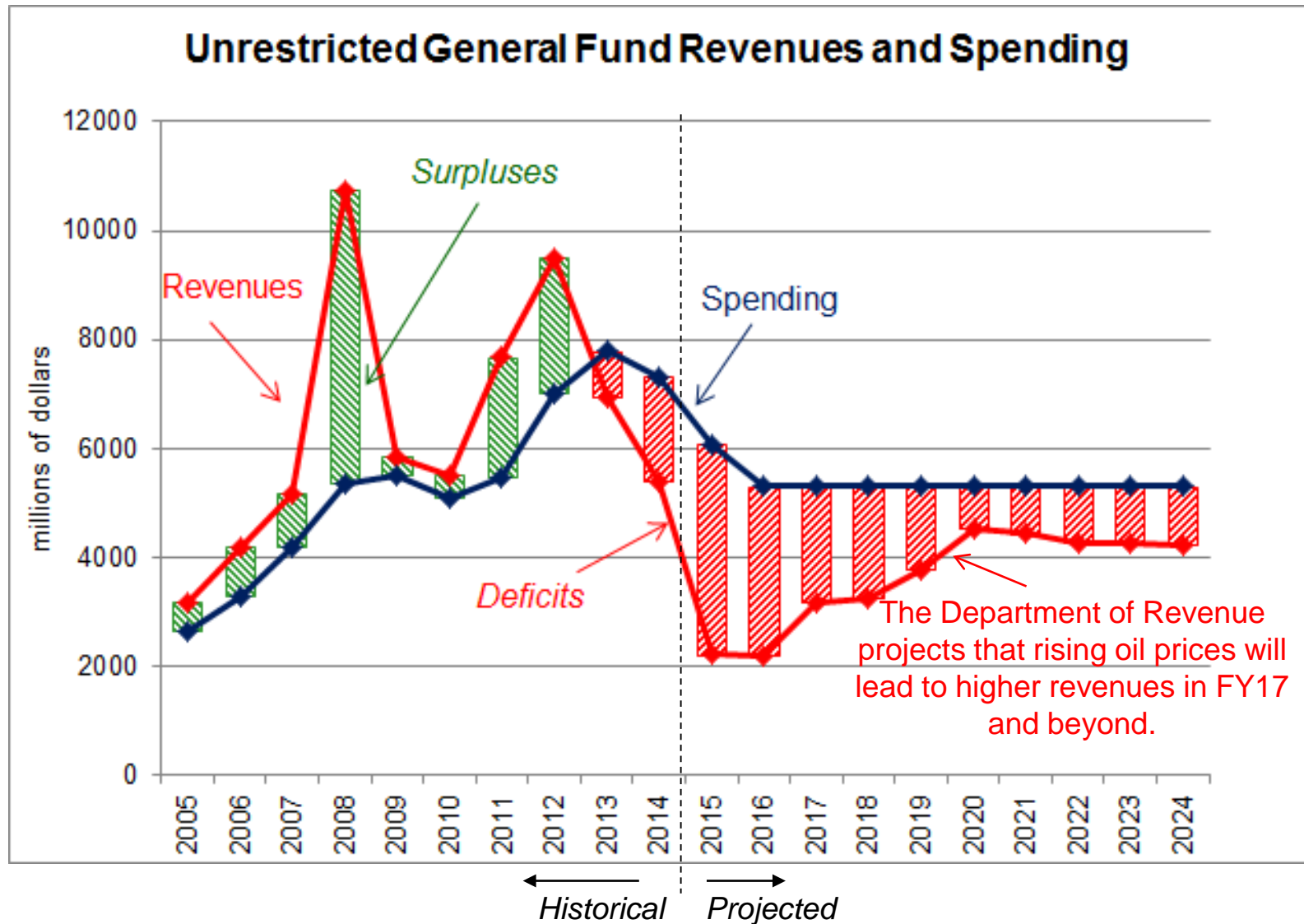


The FY16 budget will be significantly cut from the FY15 level
but the deficit will remain very large.

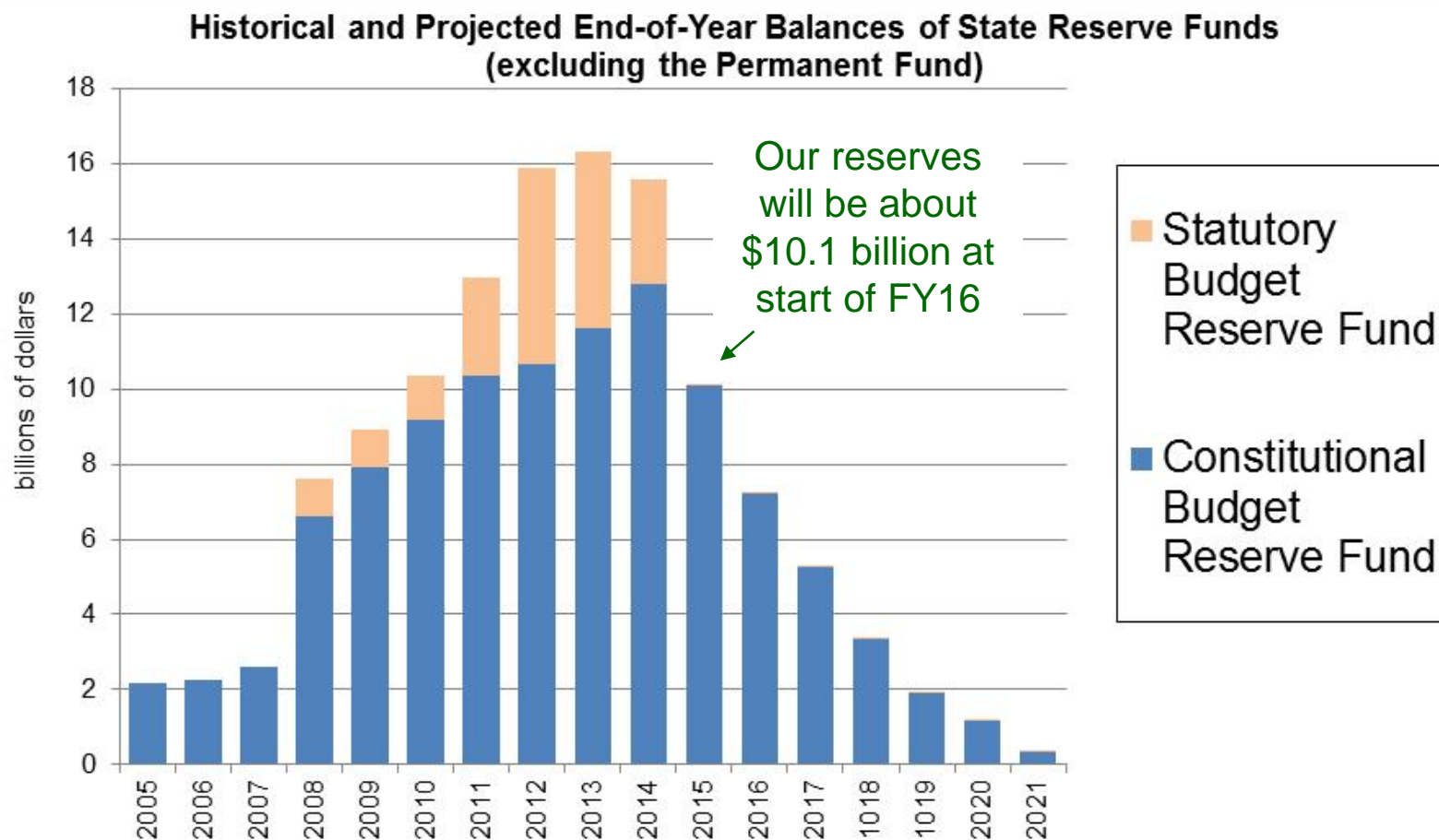


← This is a rough guess of what the FY16 budget might be. The actual level could be higher or lower. We won't know till the debate over the FY16 budget is resolved.

The Department of Revenue projects that oil prices and revenues will recover significantly. But at the FY16 budget level we would continue to run large deficits.

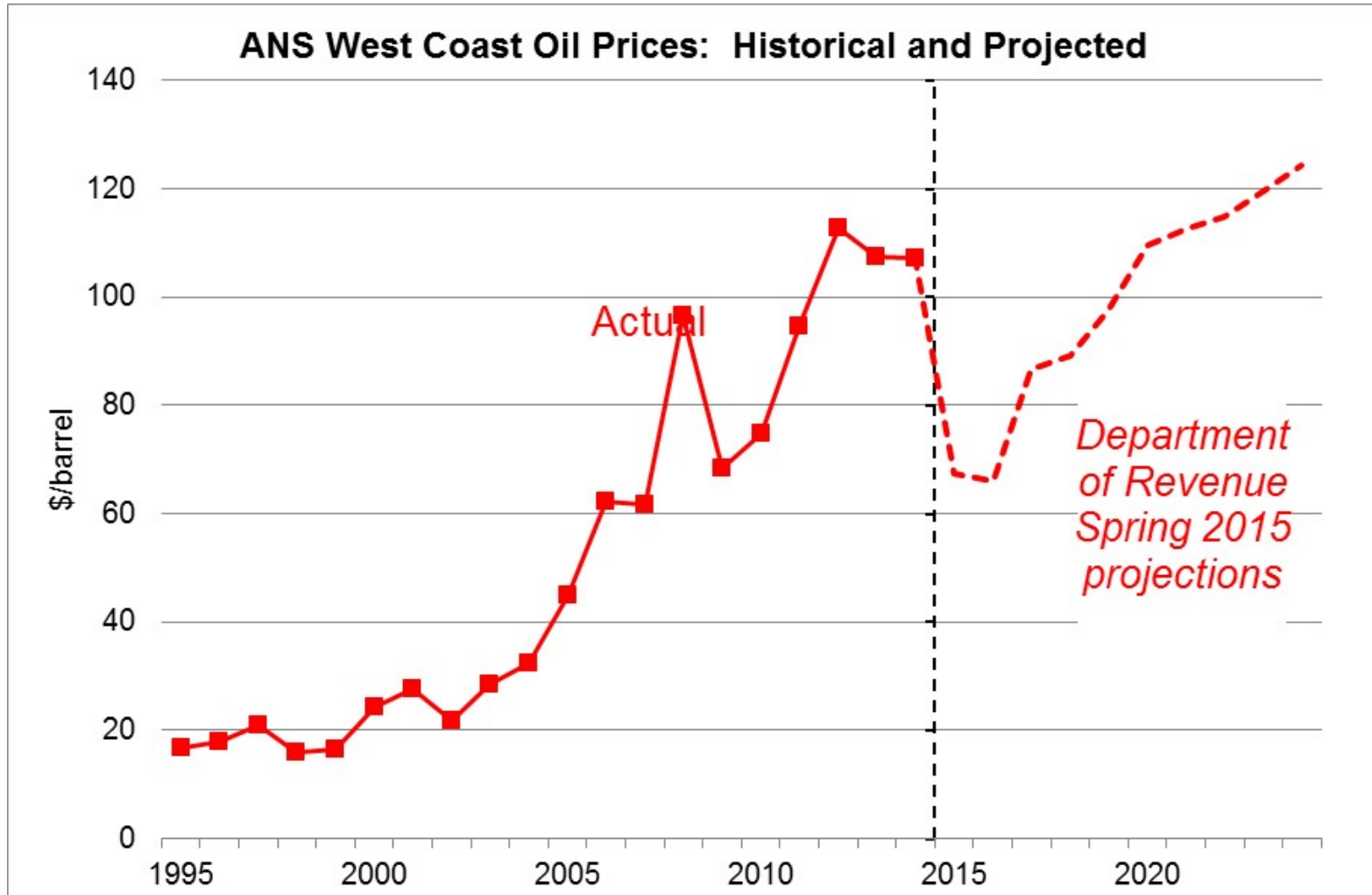


We used our past surpluses to build up two large savings reserve funds. We have been using those funds to pay for deficits. At the FY16 spending level (\$5.3 billion), the projected deficits would drain our savings reserves by FY22.



Source for historical data and FY15 projections is Legislative Finance Division. Projections beginning 2016 assume future deficits resulting from general fund spending of \$5.3 billion and general fund unrestricted revenues projected by the Alaska Depar

The Department of Revenue's projections for future state revenues assume that oil prices will rebound sharply beginning in FY17.



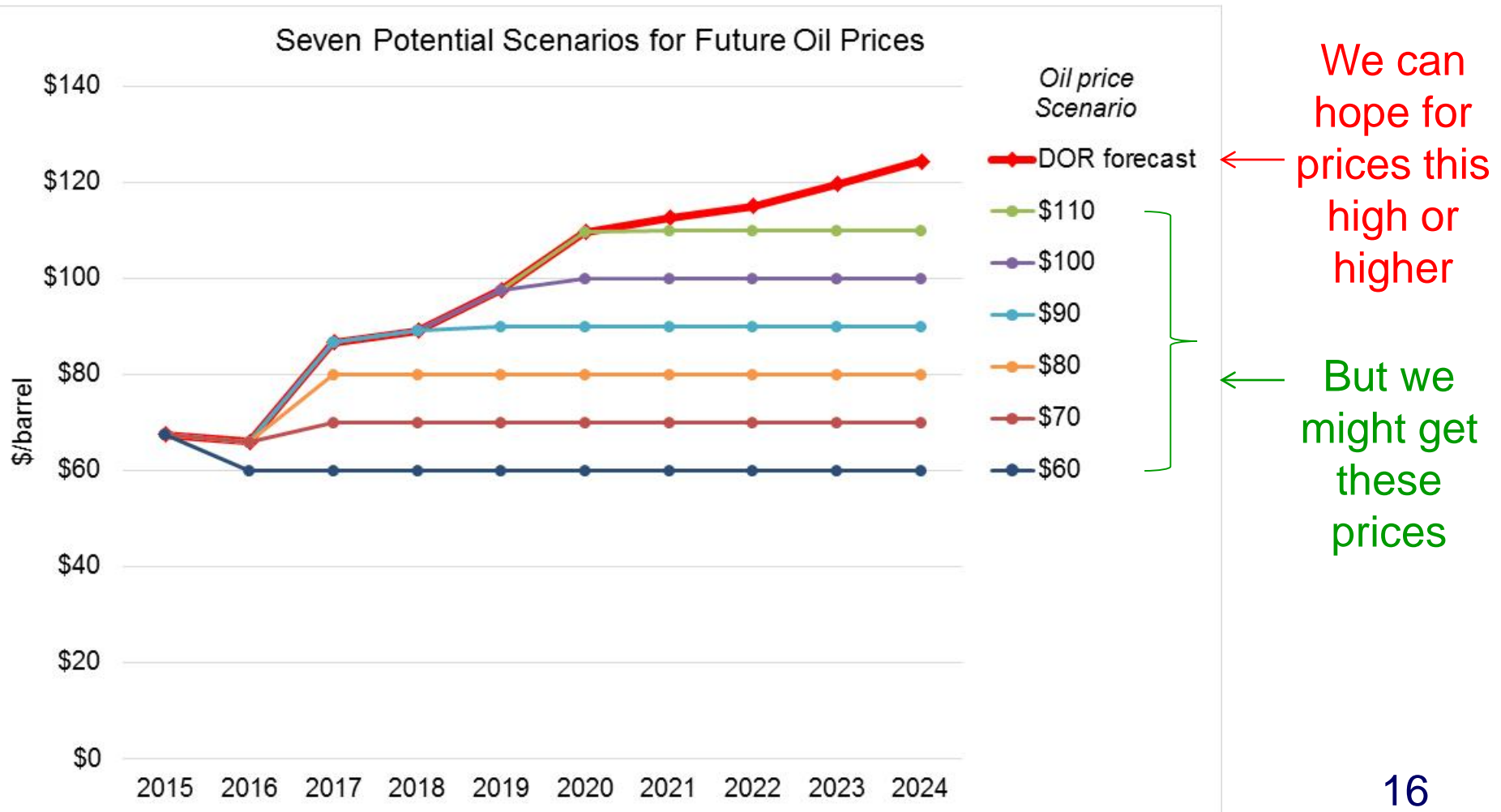
Many oil market analysts think it is unlikely that oil prices will rebound as high as the Department of Revenue assumptions. Many are predicting that prices won't rise above the \$70-\$100/barrel range.

Why not?

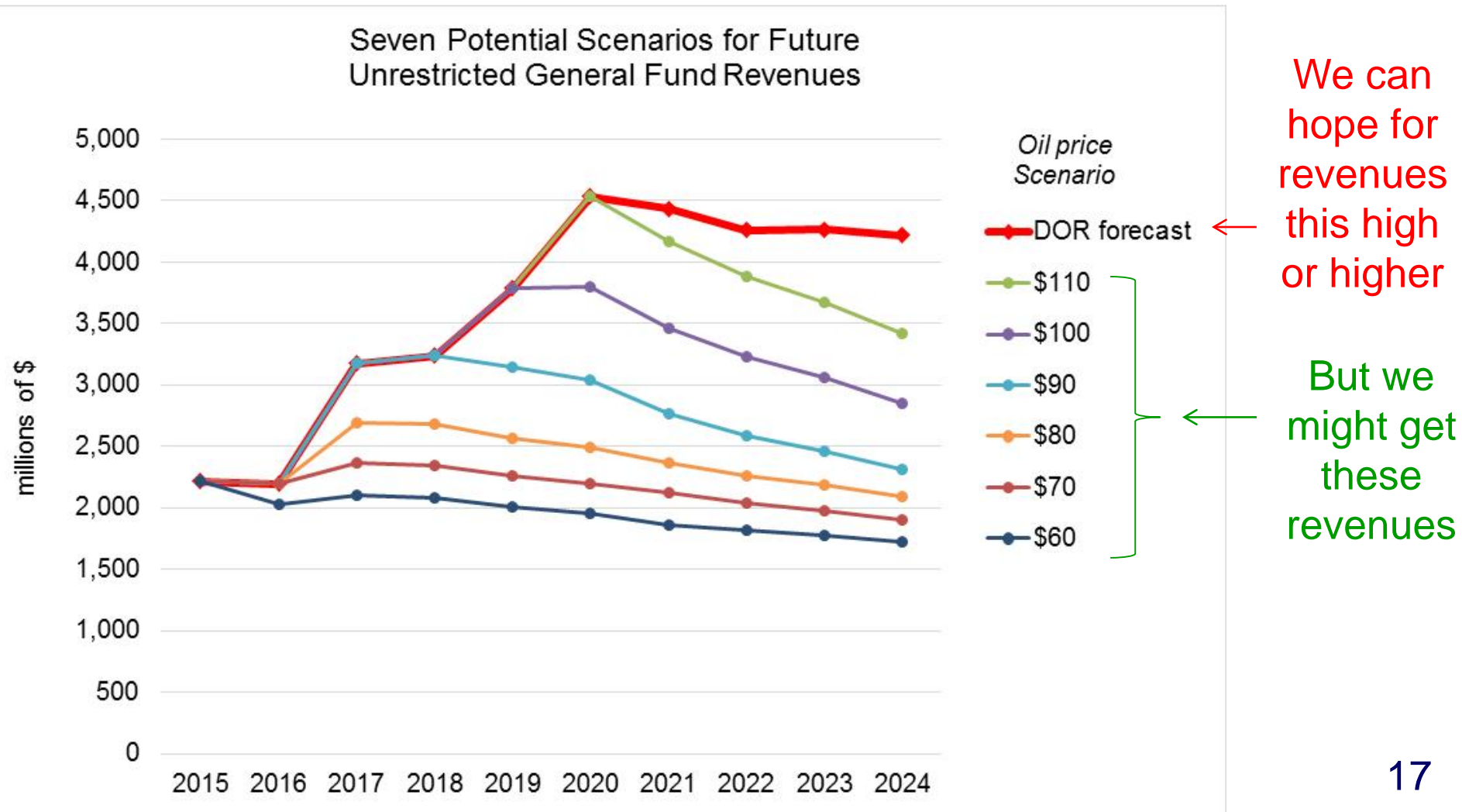
- Ability of oil producers to quickly expand production as prices rise
 - Shale oil producers
- Slowing growth in world oil demand:
 - Growth in renewable energy production
 - Efforts to reduce carbon emissions

But what will actually happen to oil prices is highly uncertain!
No one predicted that prices would fall this fast and far this year.

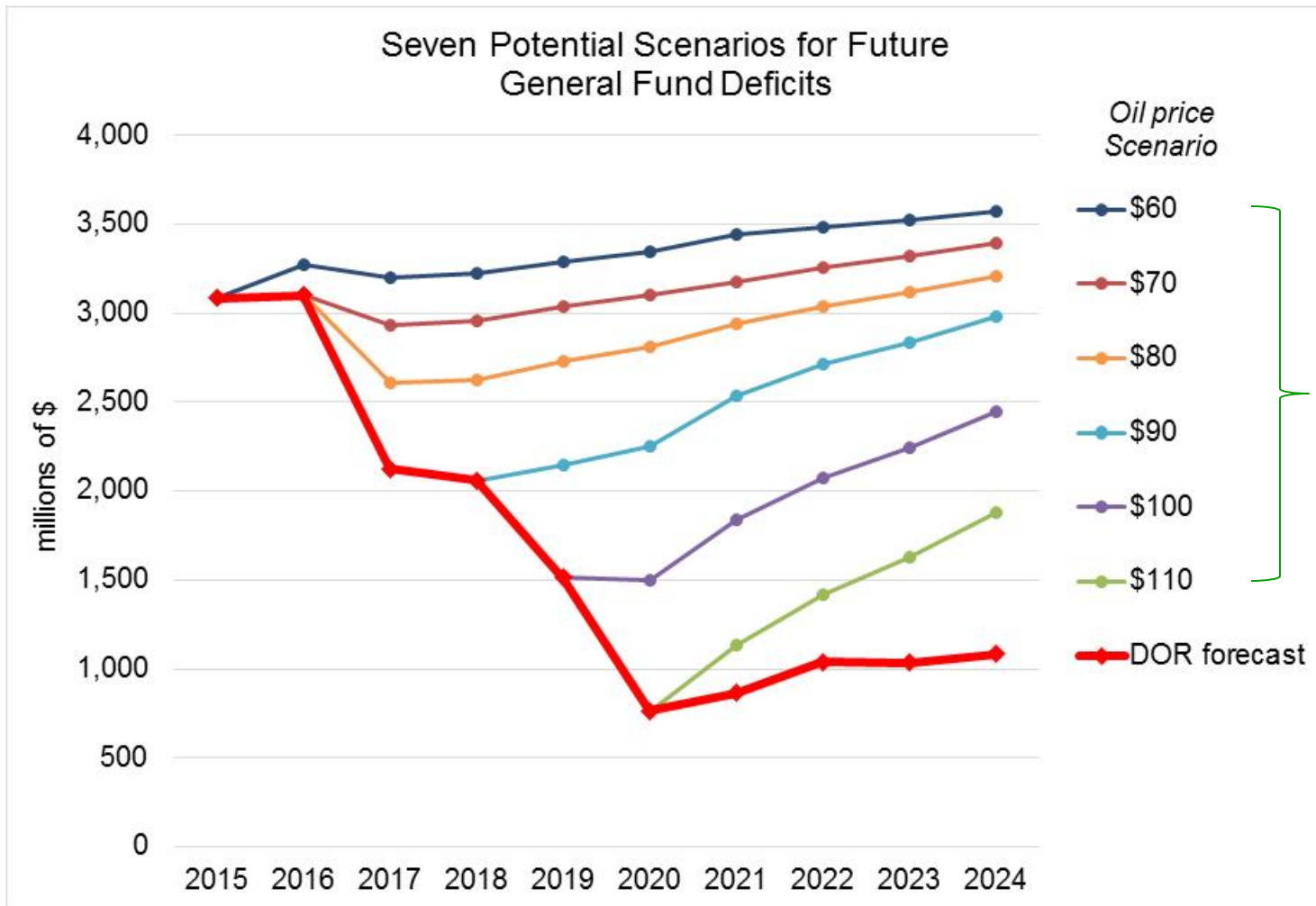
We don't know how oil prices will change.
We can hope that they rise as high as the
Department of Revenue's projections—or higher.
But we can't count on it.



Because we don't know what oil prices will be,
we don't know what our future oil revenues will be.



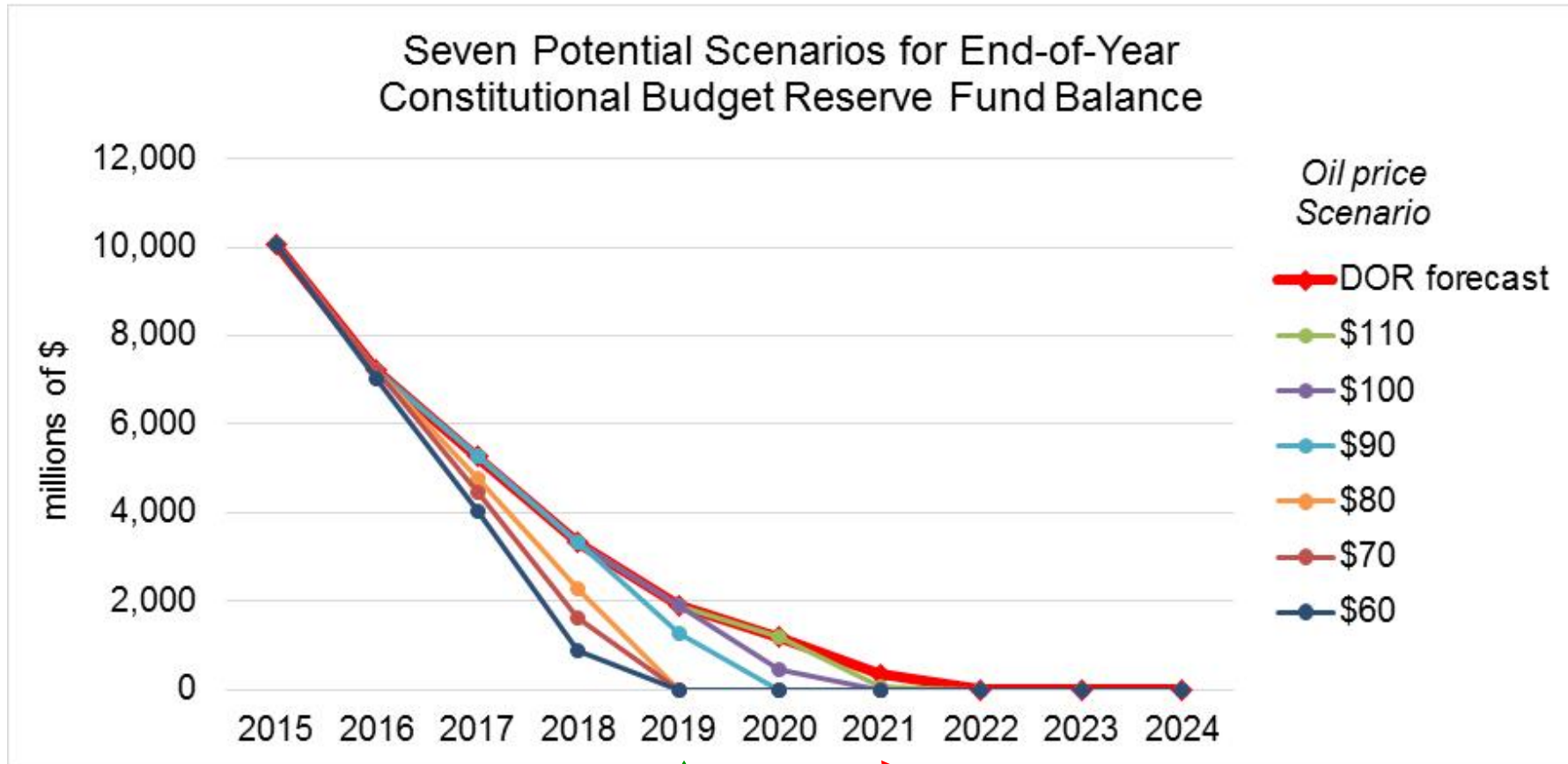
Because we don't know what our revenues will be,
we don't know how big the future deficits we could be facing
If we keep spending at the FY16 level (\$5.3 billion).



We could face deficits this big

Although we can hope for deficits this "low" or lower

If we keep spending \$5.3 billion every year,
we don't know how soon we might drain out savings reserves.

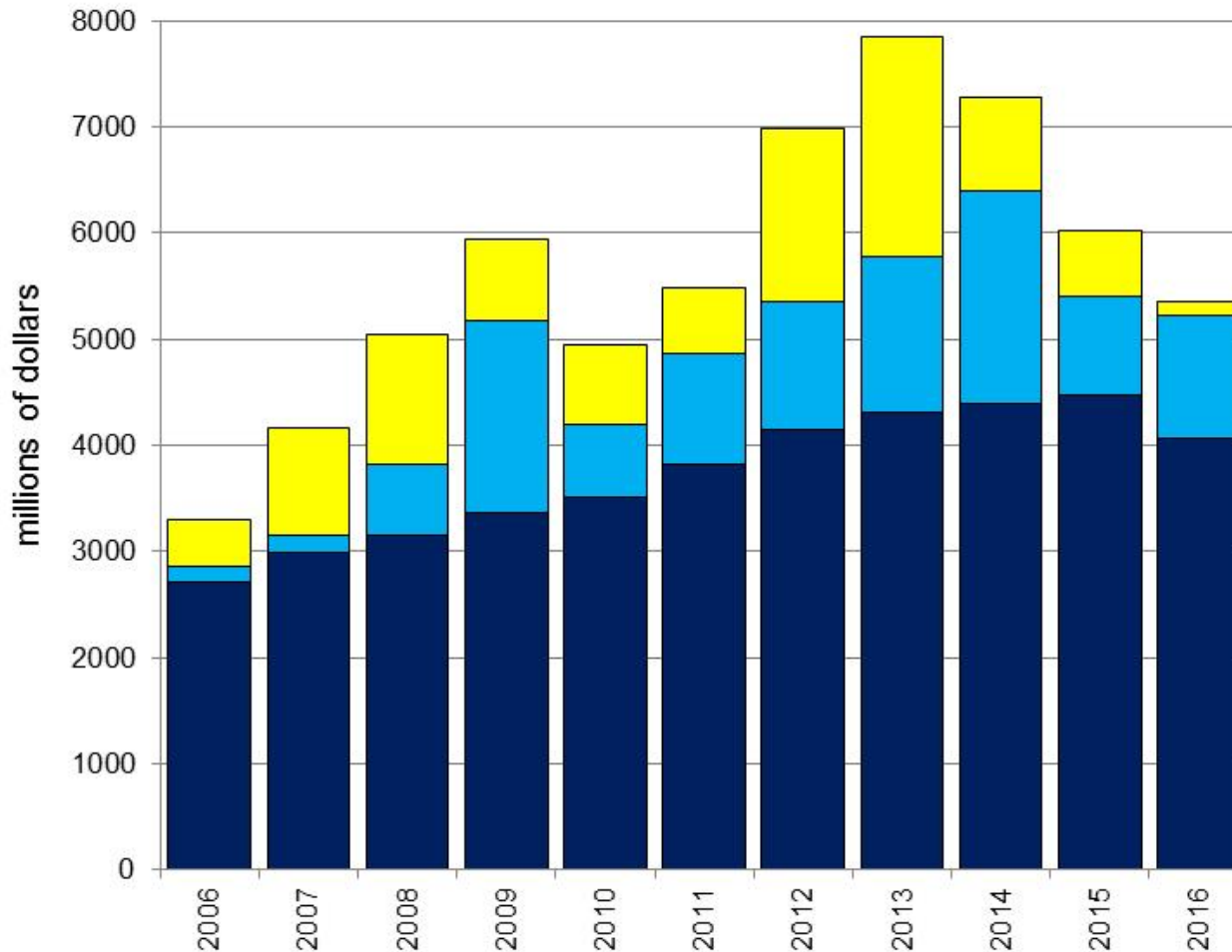


We could
drain them as
early as 2019

Although we can
hope they would last
through 2021 longer

State spending has three main components:
Capital, Statewide Operations, and Agency Operations.
Each is driven by different factors and shows different trends over time.

Total Unrestricted General Fund Budgets, FY06-FY15

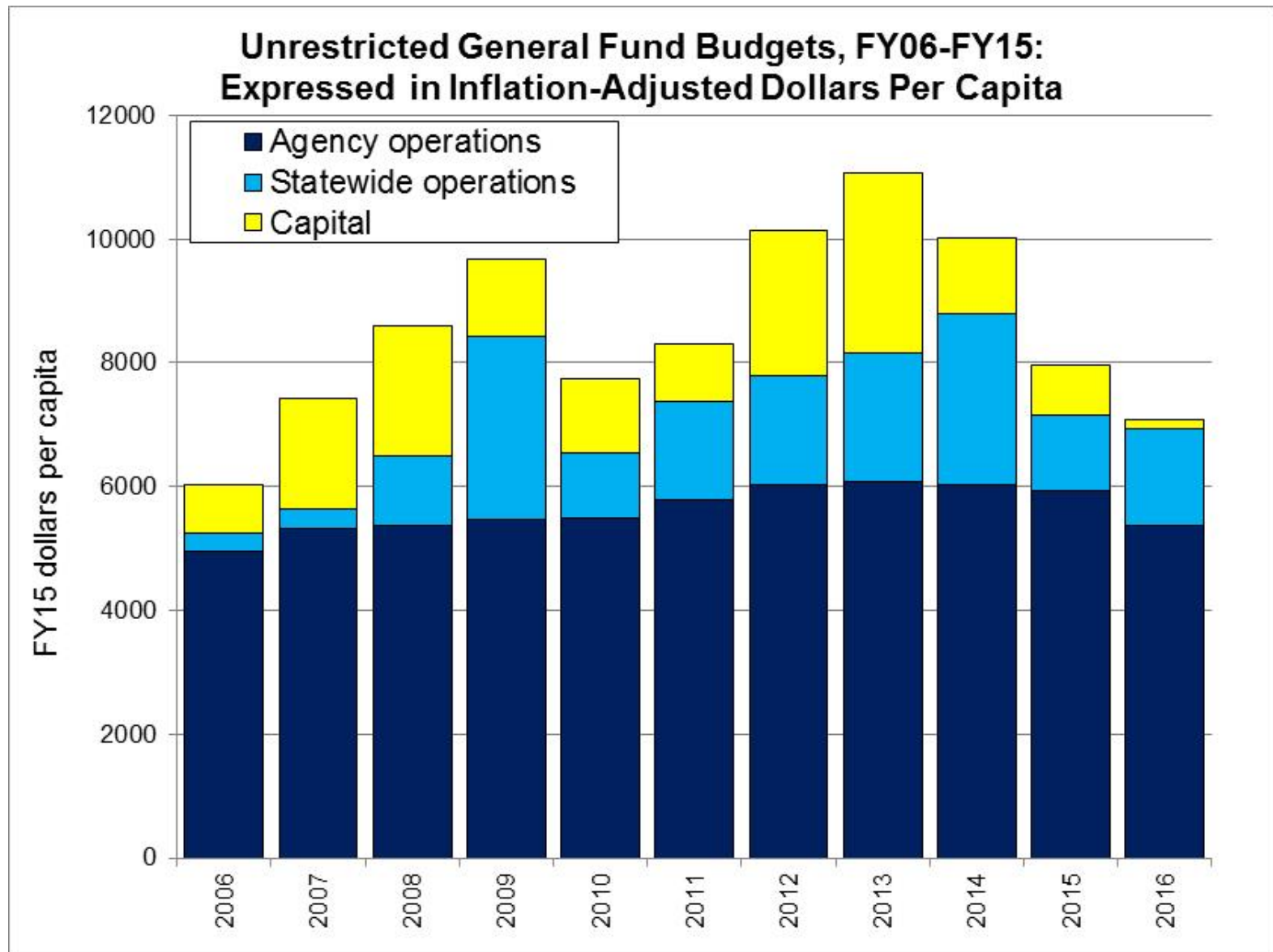


CAPITAL BUDGET:
*Roads, buildings,
etc.*

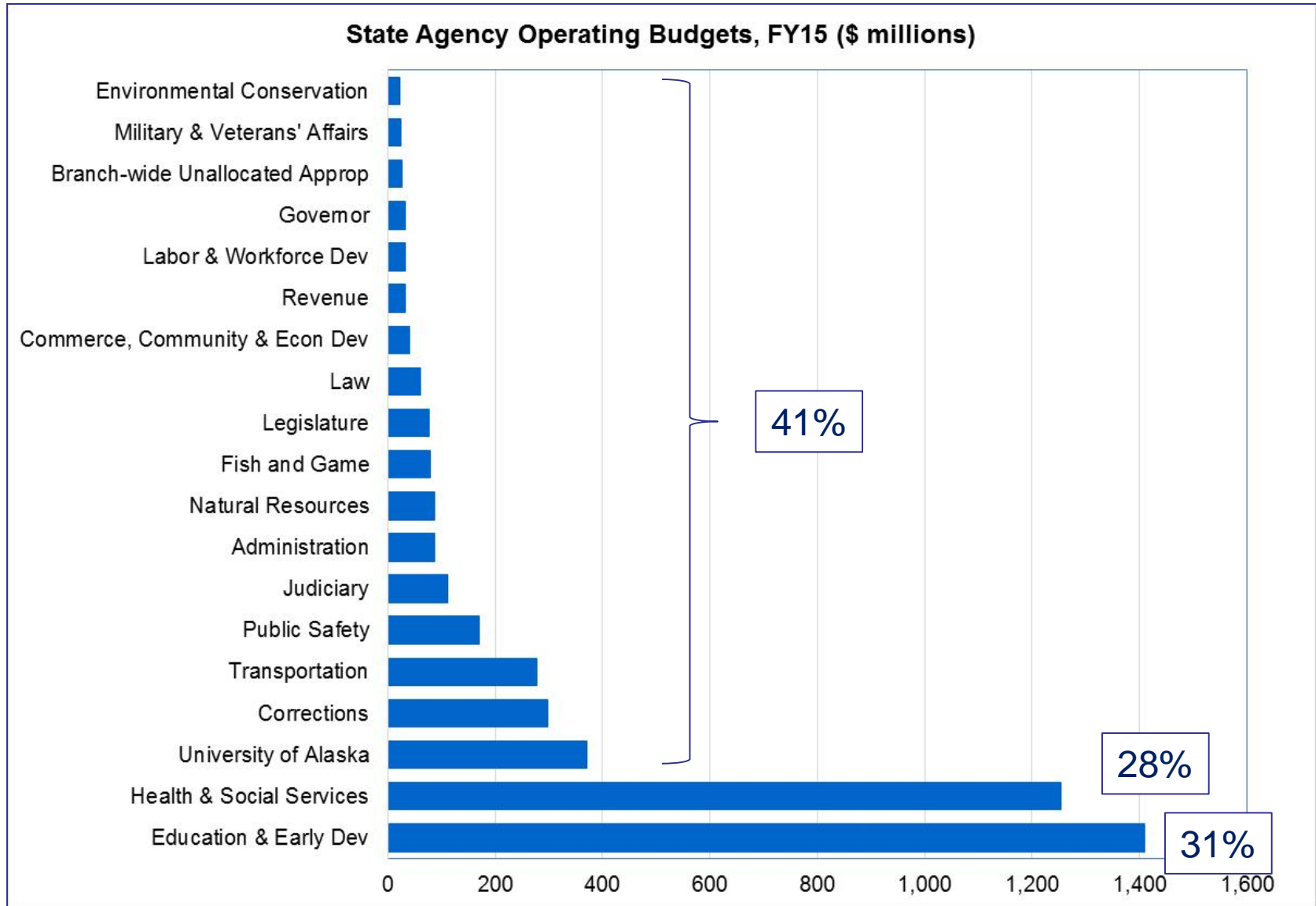
**STATEWIDE
OPERATIONS
BUDGET:**
*Debt service,
retirement
contributions,
oil tax credits, etc.*

**AGENCY
OPERATIONS
BUDGET:**
*State
agencies*

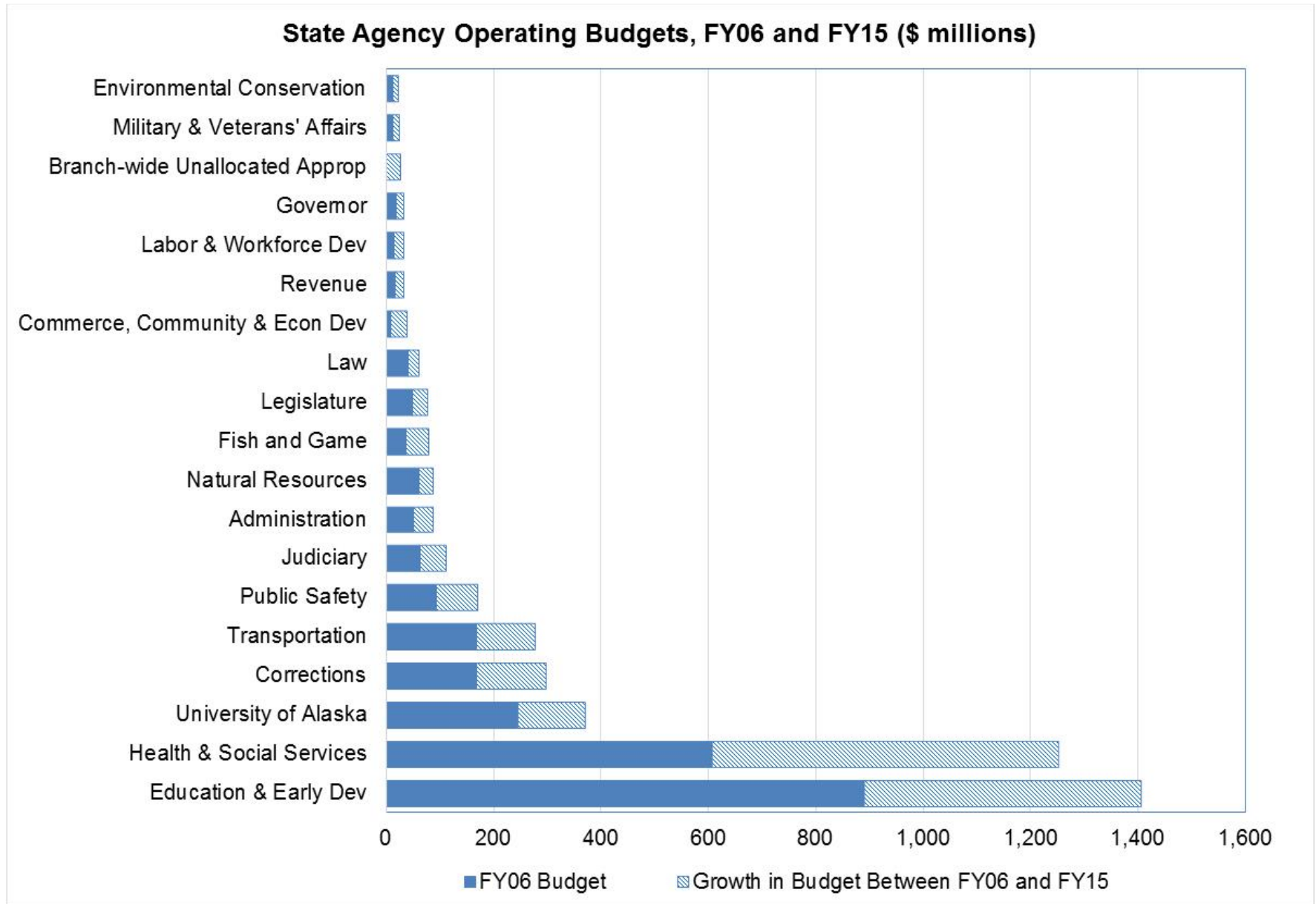
Adjusted for inflation and population growth, agency operations *spending per Alaskan* did not grow dramatically between 2006 and 2015. After the FY16 budget cuts it will be almost the same as the 2006 level.



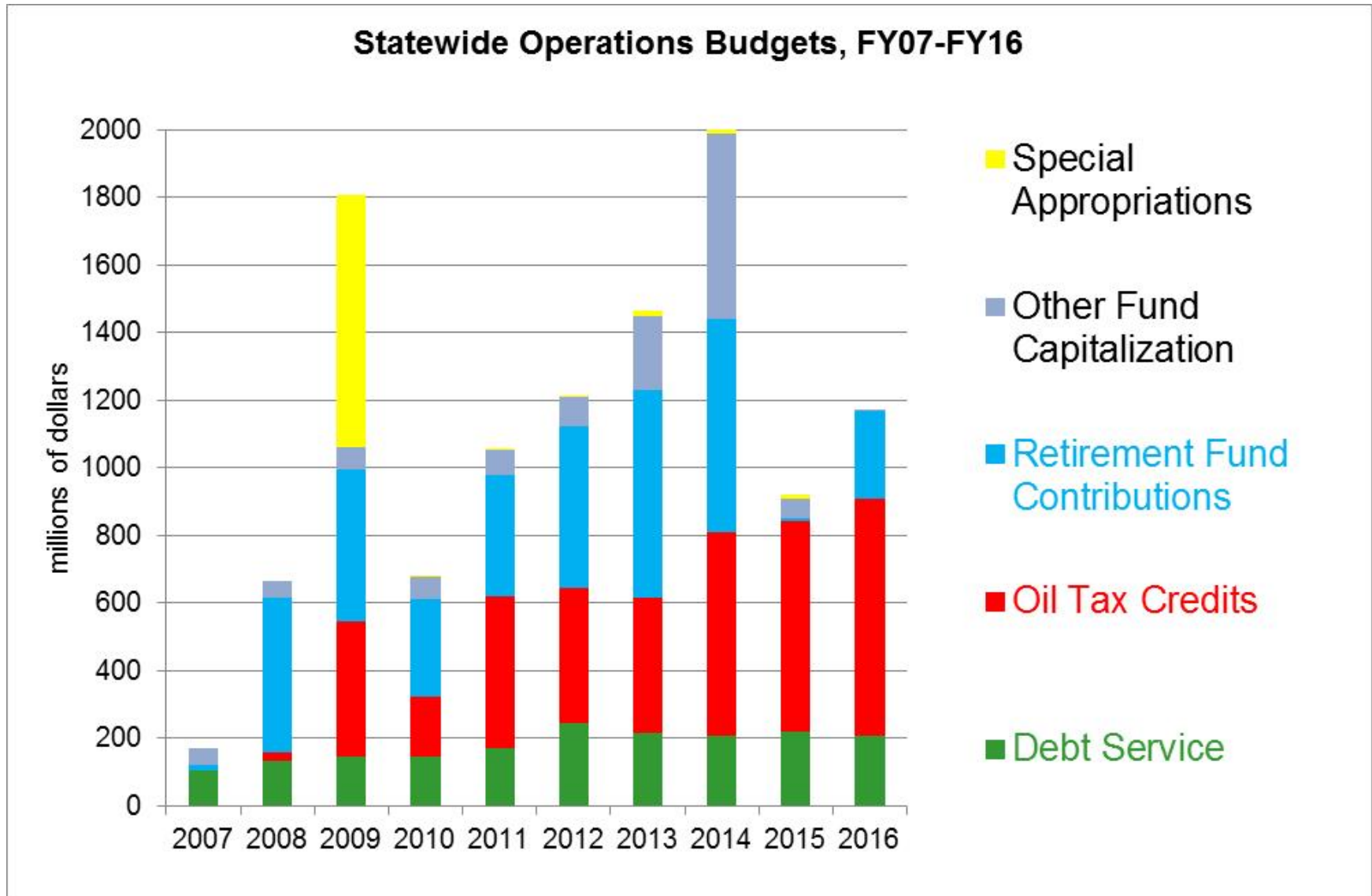
Education and Health account for 59% of the FY15 agency operations budget.



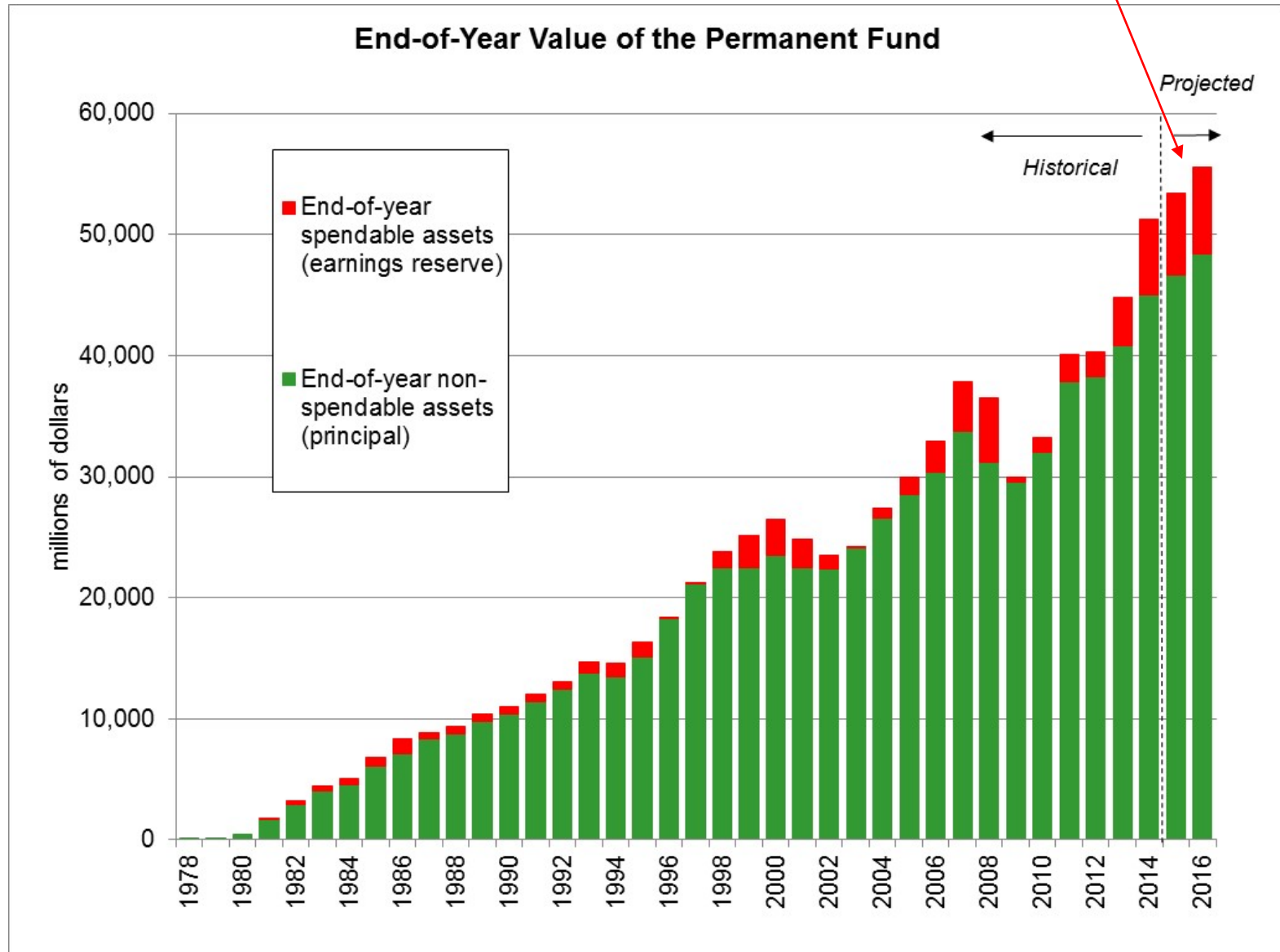
Growth has occurred in all agencies' budgets since FY06.



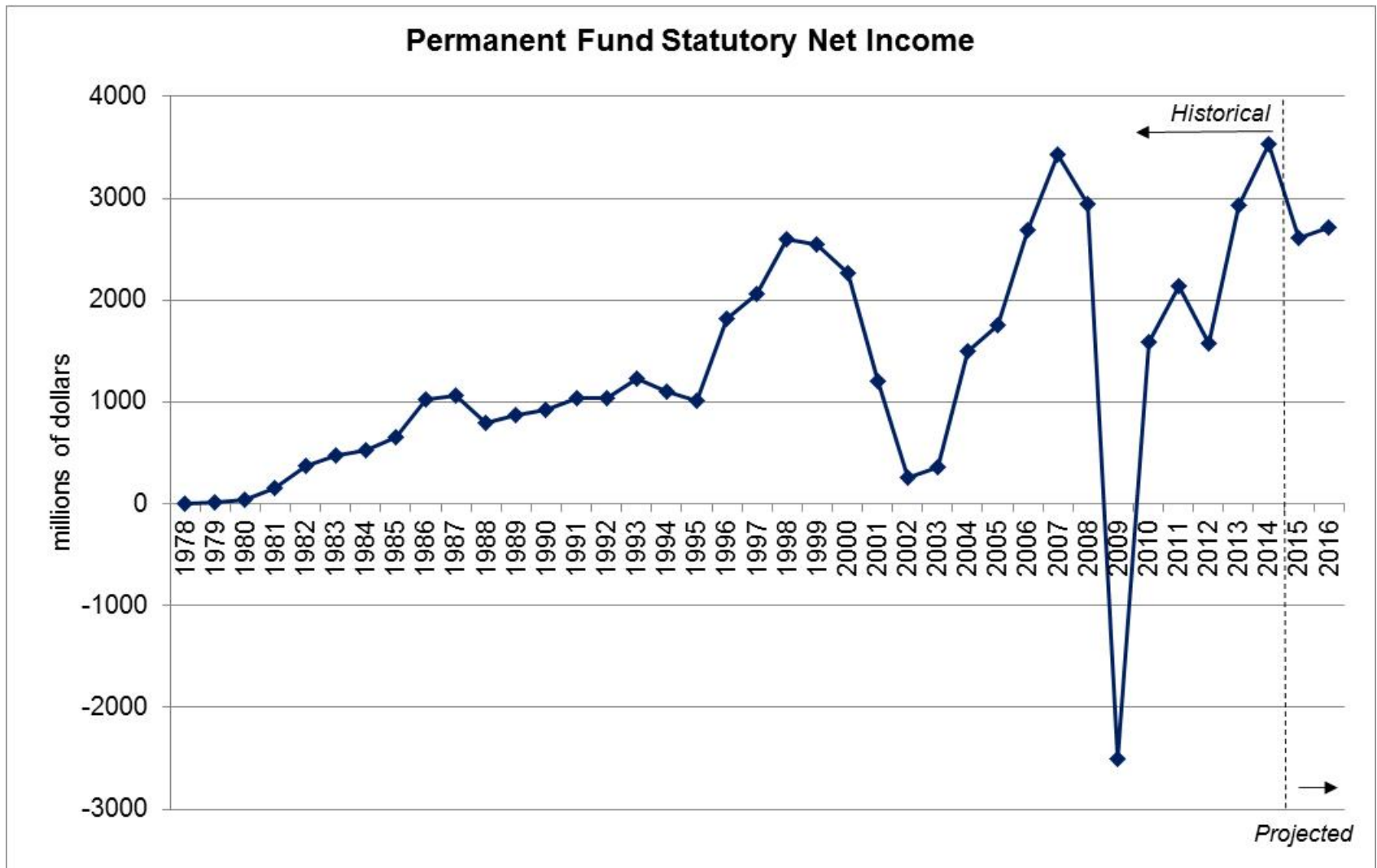
The largest components of the statewide operations budget are **debt service**, **oil tax credits**, and **retirement fund contributions**.



The Permanent Fund is worth more than \$50 billion. We can only spend the “realized earnings” in the **earnings reserve**, which are currently about \$7 billion.

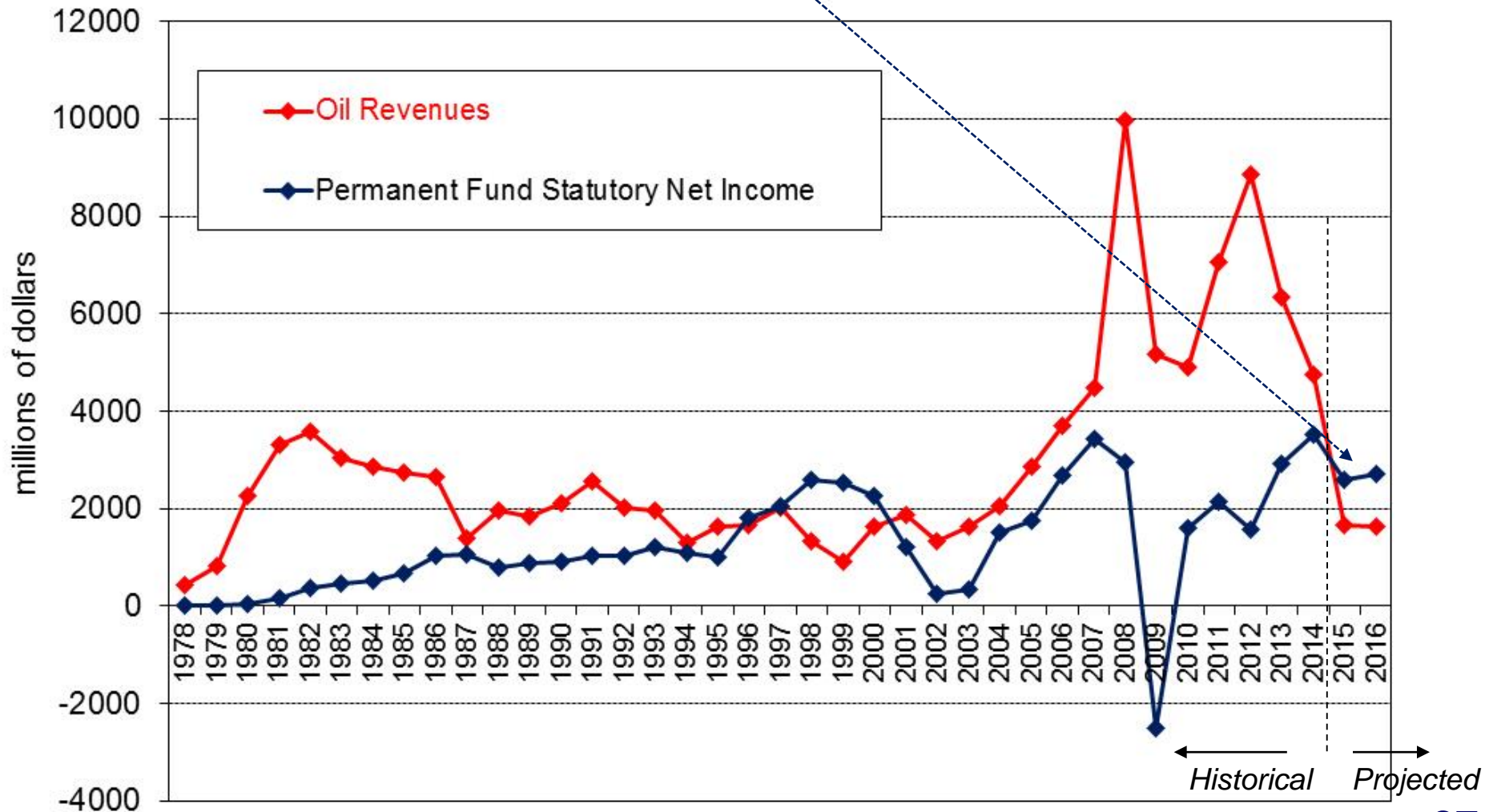


The Permanent Fund has been earning billions of dollars in realized earnings or statutory net income most years. We have been putting that income in the earnings reserve.

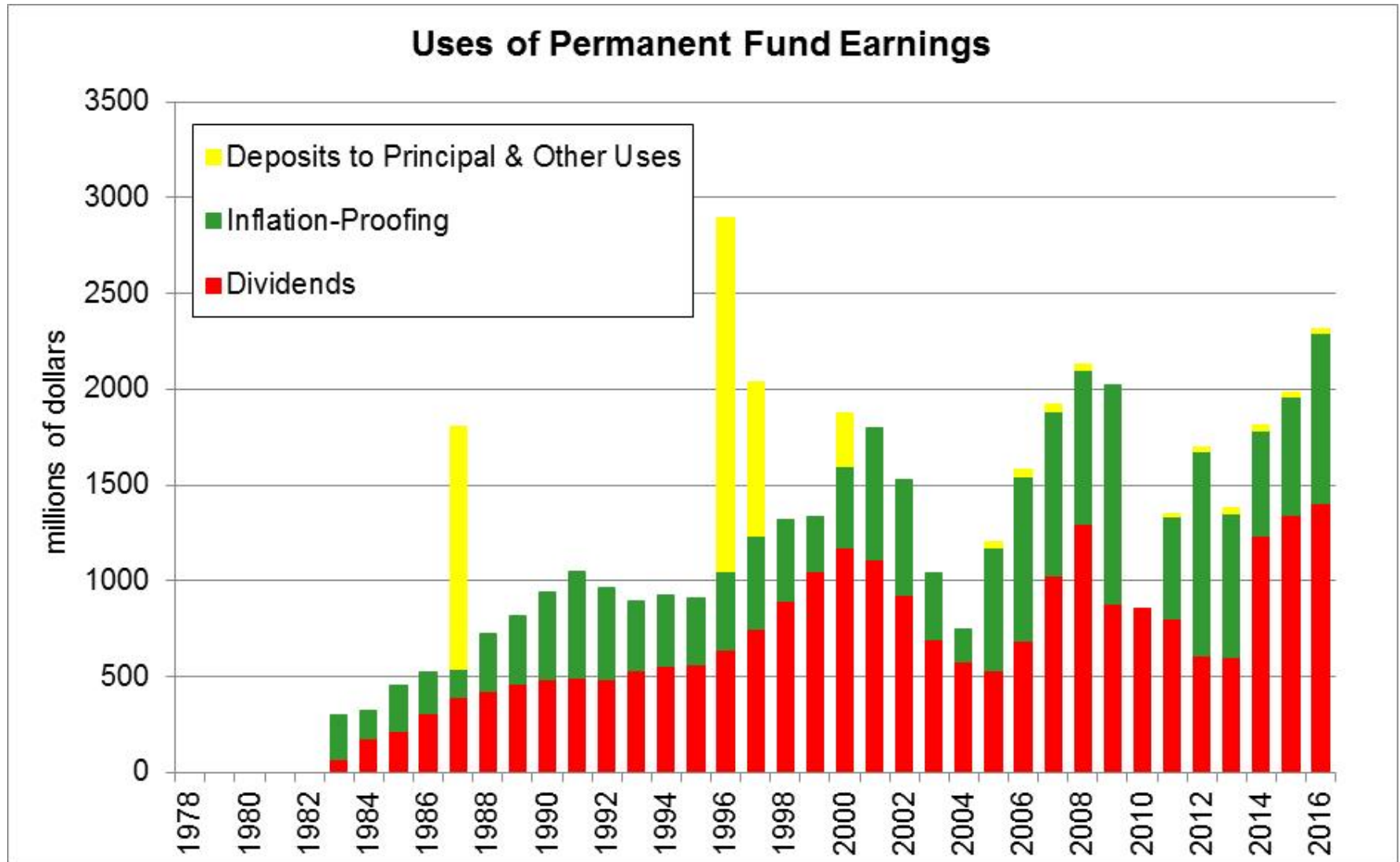


The Permanent Fund statutory net income is highly variable but it has been growing as the Fund grows. This year it is more than our oil revenues.

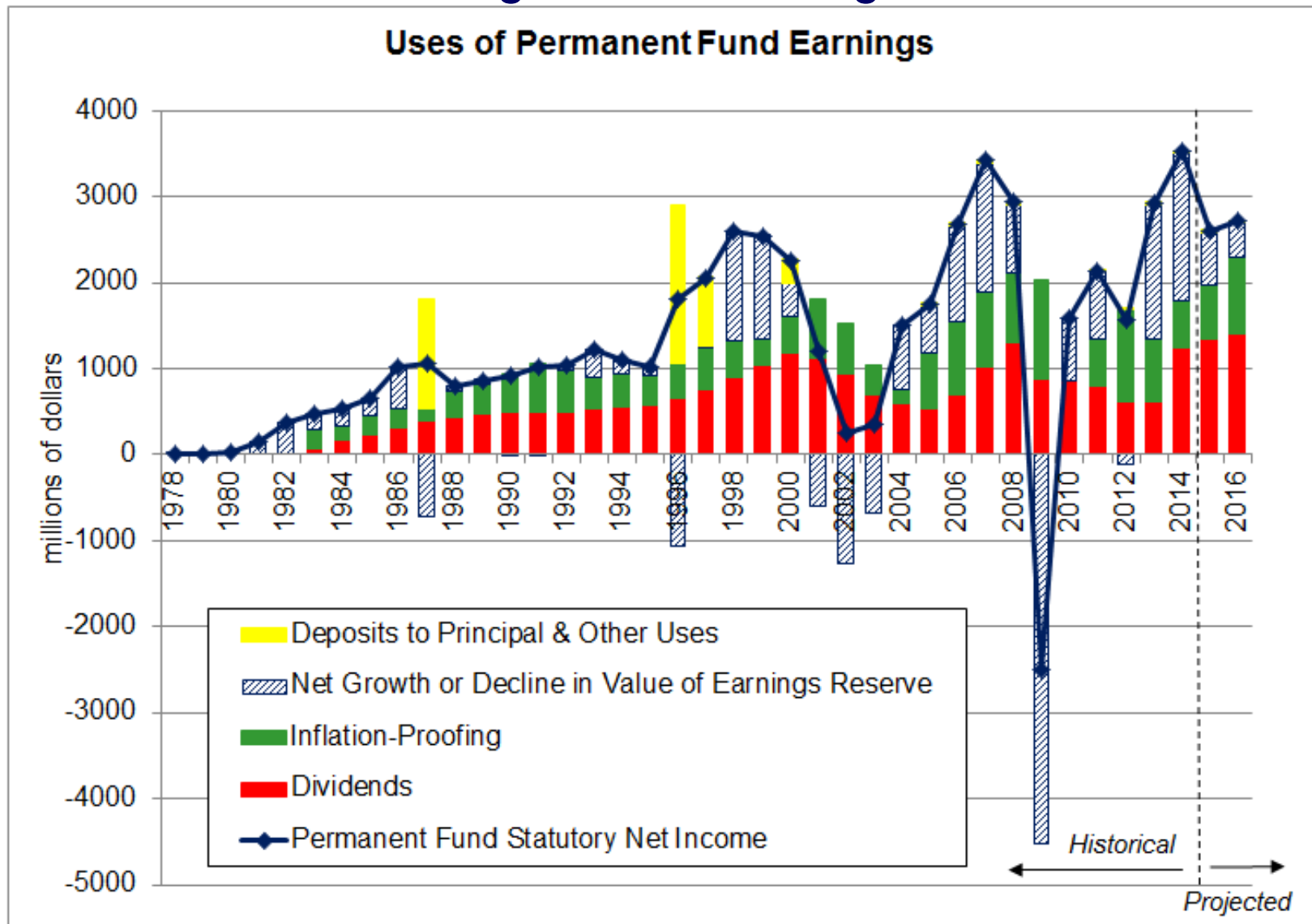
Alaska Unrestricted General Fund Revenues and Permanent Fund Statutory Net Income



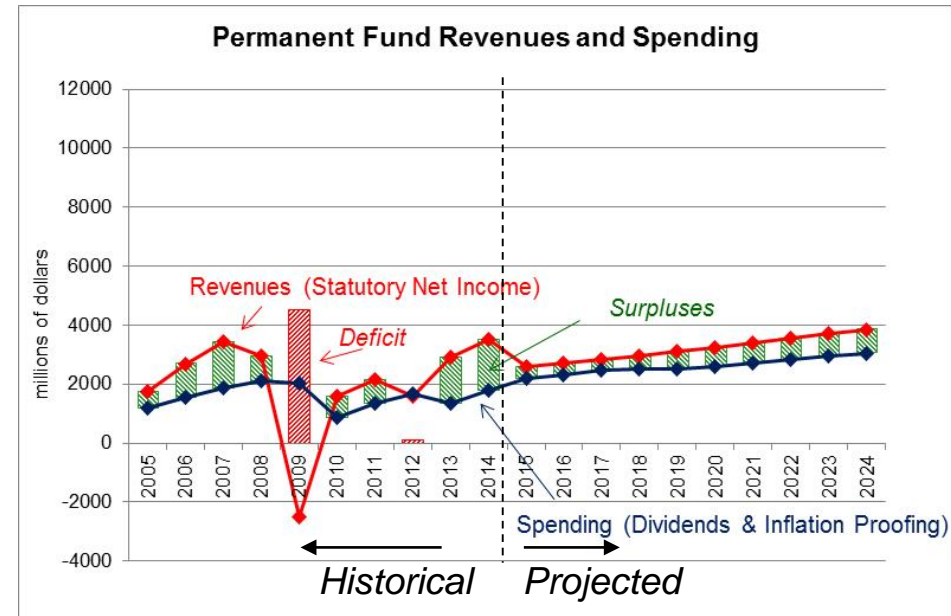
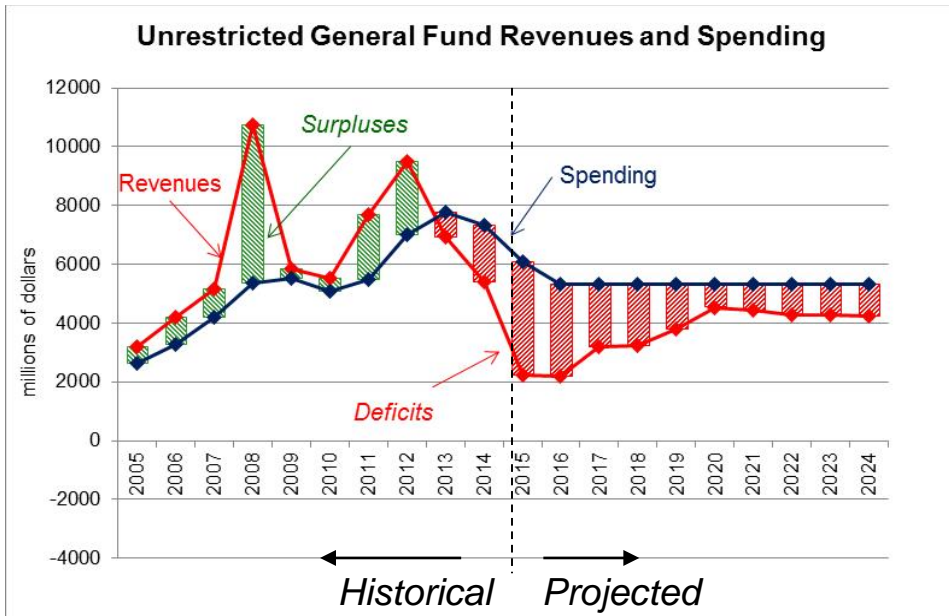
Since 1983 we have been drawing from the earnings reserve to pay for **dividends** and **inflation proofing**.



Not all Permanent Fund earnings have gone to dividends and inflation proofing. In most recent years we have also retained some earnings in the earnings reserve.



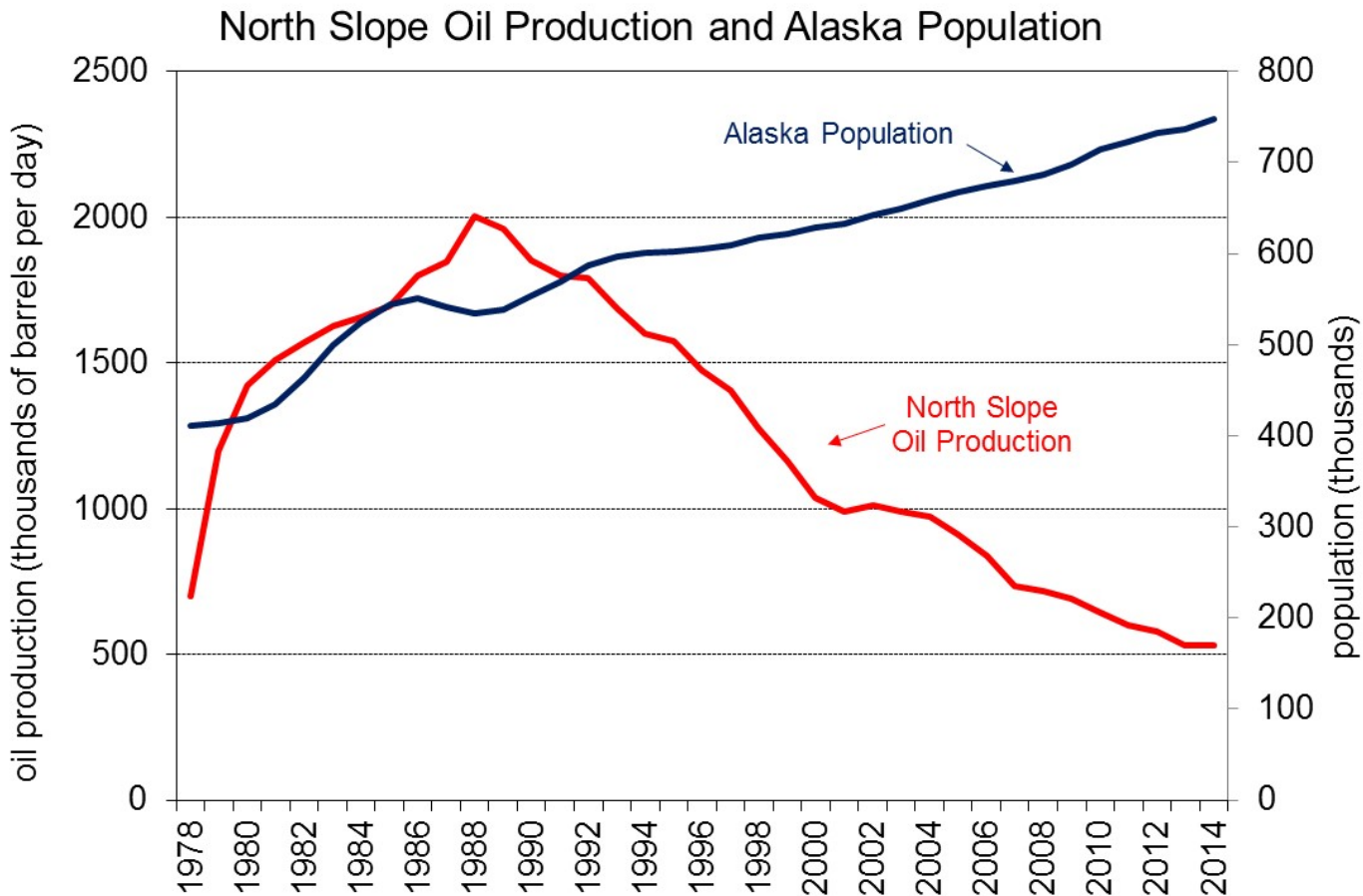
We are projecting future General Fund deficits.
In contrast, we are projecting future Permanent Fund surpluses—
earnings exceeding dividends and inflation proofing.



Our total projected deficits (General Fund and Permanent Fund combined)
are less than our General Fund deficits.

Our fundamental fiscal problem:
Alaska oil production is falling and our population is rising.

It is hard for falling oil production to support most of
state government for a growing population.



II. ALASKA FISCAL CHOICES

When and how will we fill the funding gap
between what we are spending
and our current revenues?

If we continue to spend at the FY16 level of ~\$5.3 billion and use only our current revenue sources, we face a large **funding gap** between our spending and our revenues—which we will have to pay for from our savings reserves.

The lower the price of oil, the sooner we will drain our reserves and the bigger the remaining funding gap will be.

| If prices only rise to . . . | Our savings would run out in . . . | . . . when the funding gap between spending and revenues would be |
|------------------------------|------------------------------------|--|
| DOR forecast | 2022 | \$1.0 billion |
| \$100 | 2021 | \$1.8 billion |
| \$90 | 2020 | \$2.3 billion |
| \$80 | 2019 | \$2.7 billion |
| \$70 | 2019 | \$3.0 billion |

We face two fundamental choices:

WHEN WILL WE FILL THE FUNDING GAP?

HOW WILL WE FILL THE FUNDING GAP?

WHEN WILL WE FILL THE FUNDING GAP?

The longer we delay:

The less the immediate pain
The less unnecessary pain if oil prices unexpectedly recover

but

The sooner we risk draining our reserves
The bigger the risk of facing drastic immediate adjustments
The greater the risk to investor confidence
The greater the risk to our credit rating
The lower our future investment earnings from savings
The less savings we leave for future generations

HOW WILL WE FILL THE FUNDING GAP?

Our only significant and practical options are some combination of:

Spending cuts
New revenues
Use Permanent Fund earnings

None of these options are easy or popular.

Options for closing the funding gap:

Spending cuts . . .

- Capital budget cuts
 - Very little is left to cut
- Statewide operations cuts
 - We can't cut debt service
 - Cutting retirement contributions would be very difficult
 - We could cut oil tax credits—but that could affect future production
- Agency operations cuts
 - Most cuts would have to come from agency operations
 - Significant cuts would require cutting the largest agencies:
 - Education & Early Development
 - Health and Social Services

Options for closing the funding gap:

New revenues . . .

Alaskans are talking about many options.

Each option raises questions:

- How much money would it generate?
- How long would it take and what would it cost to implement?
- Who would bear the burden?
- How would it affect the economy?
- What risks does it pose?

Any revenue option would take time to implement.

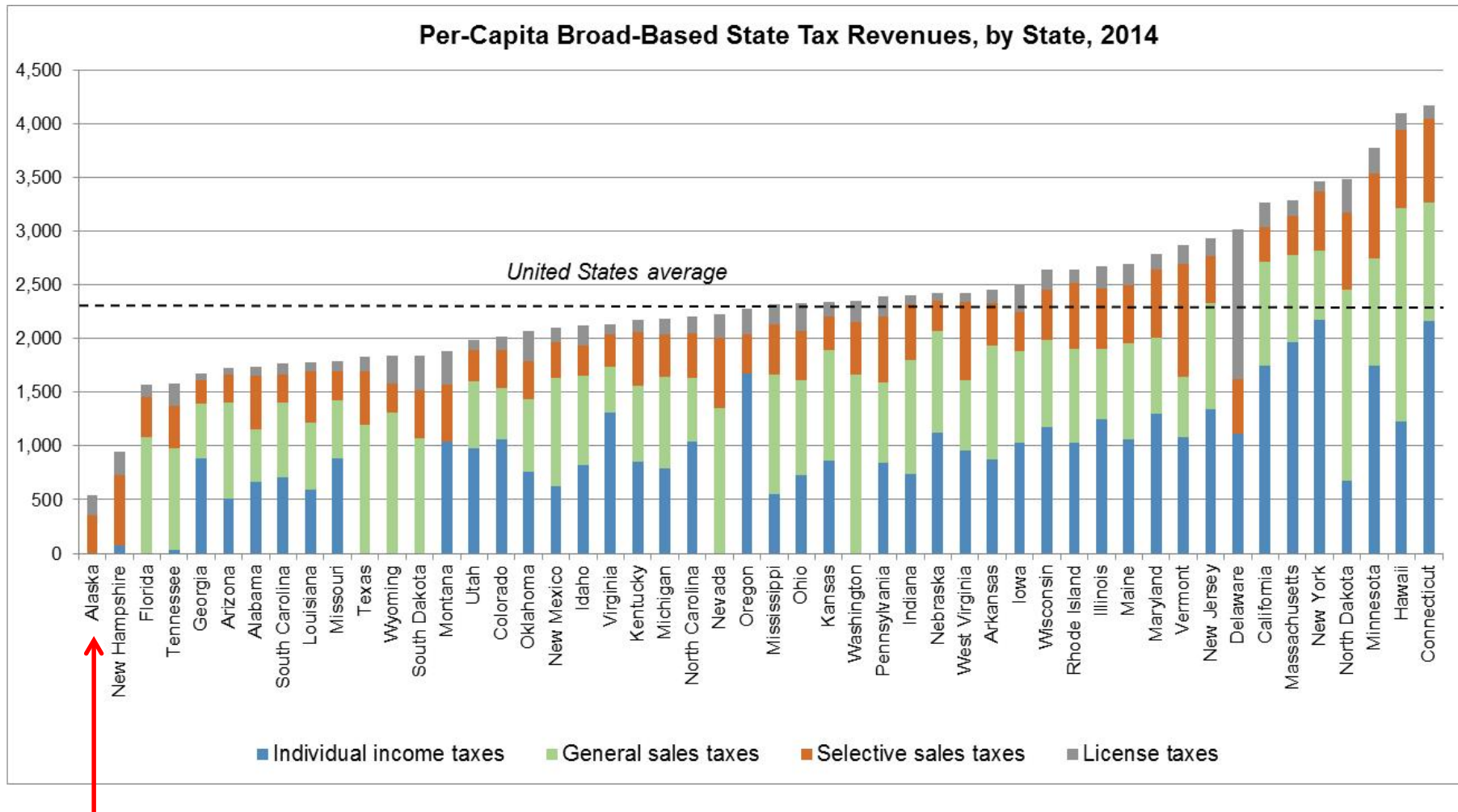
Any revenue option needs careful study and debate.

For any new revenue option, the devil is in the details!!!!

Some of the **new revenue** options Alaskans are talking about . . .
 . . . and some of the issues they raise

| Option | Some of the Issues |
|--|---|
| Increase oil revenues | Issues which arose in last year's oil tax debate |
| Increase other resource revenues (mining, seafood, tourism, etc.) | Ability of these industries to pay |
| Economic diversification | What new industries? Ability of these industries to pay |
| Increase return on state funds | What are the risks? |
| LNG project | Still a long time away and many uncertainties |
| Income taxes | Who bears the burden? Effects on the economy? Potential to tax non-resident workers? |
| Sales taxes | Who bears the burden? Effects on the economy? Effects on local government revenues? Potential to tax tourists? |

Alaskans pay much lower broad-based state taxes than residents of any other state.

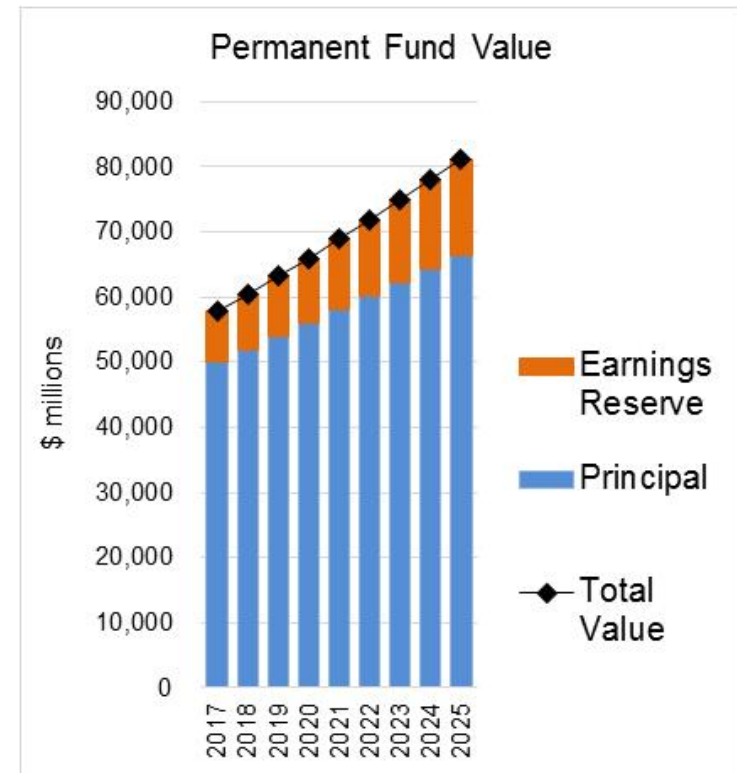
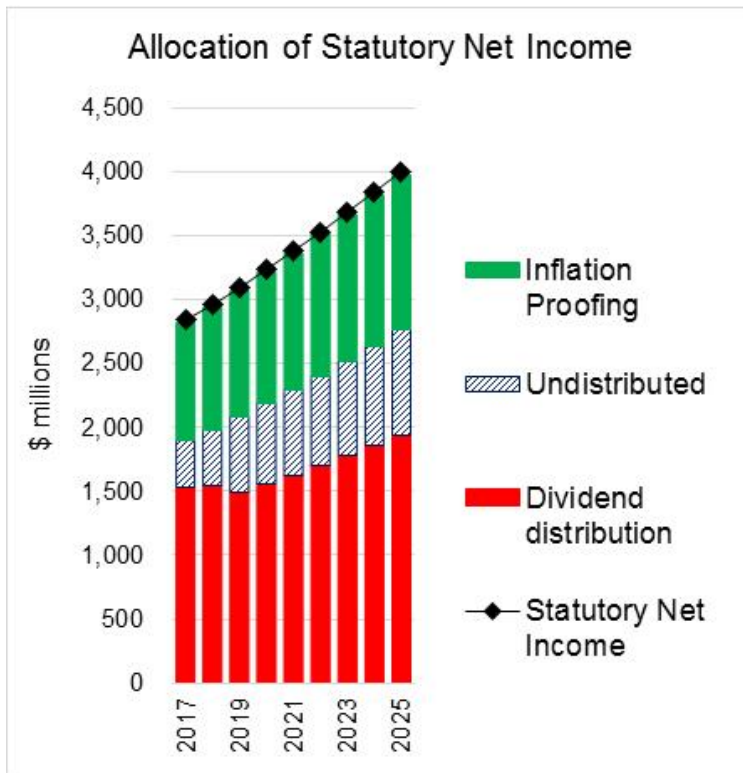


Alaska

Options for closing the funding gap: Use Permanent Fund earnings . . .

- Earnings, dividends and the fund value are all projected to grow
- We haven't been spending all the earnings
- We could use some earnings and still keep or grow dividends

Alaska Permanent Fund Corporation Projections, 2017-2025



Two key questions in any use of Permanent Fund earnings

| | How much should we distribute from earnings? | How much should go to dividends and how much to government? |
|-----------------------------------|--|---|
| What we do now | Distribute half of average statutory net income over the previous five years | 100% goes to dividends |
| Some examples of what we could do | Keep the same formula Distribute a higher share of statutory net income Distribute a fixed percent of market value | Cap the dividends Use the rest for government Keep dividends the same Use the increase in distributions for government |

How would YOU fill the funding gap?

| Price scenario | DOR forecast | Prices only rise to \$100/barrel | Prices only rise to \$80/barrel |
|---|---------------|----------------------------------|---------------------------------|
| Potential funding gap | \$1.0 billion | \$1.6 billion | \$2.7 billion |
| How much would you cut spending? | | | |
| <i><u>What</u> would you cut?</i> | | | |
| How much would you increase revenues? | | | |
| <i><u>How</u> would you increase revenues?</i> | | | |
| How much Permanent Fund earnings would you use? | | | |
| <i>How would you change distributions and/or dividends?</i> | | | |

None of the options are easy!
 But we can't just talk about what we shouldn't do.
 We need to talk about what we should do.

Conclusions . . .

- Unless oil prices rise dramatically and unexpectedly, we won't have enough money to:
 - Continue spending at FY16 levels
 - Pay for it with only current revenues and our savings
- Our savings can't sustain multi-billion dollar draws very long
- We will have to adjust our spending or how we pay for it
- Our only significant and practical options are:
 - Further spending cuts
 - New revenues
 - Use Permanent Fund earnings
- None of these options are easy or popular
- Our choices affect not just ourselves but future Alaskans